KPMG

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March 10, 2005

Ms. Carol Sigmann
Executive Officer
California Board of Accountancy
2000 Evergreen Street
Suite 250
Sacramento, CA 95815-3832

Re: <u>In the Matter of KPMG LLP, Case No. AC-2005-13</u>

Dear Ms. Sigmann:

This letter is submitted to the California Board of Accountancy (the "Board") by KPMG LLP ("KPMG") in conjunction with a proposed resolution of the matter referenced above that was negotiated in good faith and in a spirit of joint cooperation between representatives of KPMG and the Staff of the Board. During that process, KPMG shared with the Staff information regarding the Firm that we believe would be relevant to the Board's consideration of the proposed settlement.

At the outset, however, we believe it is important to note the constructive and cooperative manner in which KPMG has addressed regulatory inquiries regarding the financial statements of Gemstar TV-Guide International, Inc. ("Gemstar") and the audit reports issued by KPMG on those financial statements. At the earliest stages of the regulatory inquiries, KPMG informed the Staff that KPMG had received a "Wells Notice" from the Securities and Exchange Commission ("SEC"). In doing so, KPMG became the first of the "big-four" accounting firms to accept the Board's position that licensees must report to the Board the circumstances relevant to the SEC's decision to make a "Wells call". In addition, KPMG immediately notified the Board's Staff when it had concluded a settlement with the SEC and since then has worked constructively with the Staff and its counsel to bring this matter to a resolution.

KPMG also cooperated with the SEC. In fact, the level of the Firm's cooperation with the SEC is such that we are confident that the senior Staff of the SEC's Division of Enforcement would confirm that KPMG provided substantial cooperation in the course of the investigation. Indeed the cooperation continued after the settlement was negotiated, in connection with the SEC's ongoing enforcement action against key members of Gemstar management. We understand that those enforcement actions, which featured contentions by the Commission that management had lied to KPMG, have now all been resolved.

During the course of the SEC's investigation, KPMG produced more than 50,000 pages of documents to the SEC. KPMG arranged for testimony of engagement team members over many days on an aggressively expedited schedule. Finally, despite its belief that the SEC Staff's proposed charges were defensible (as demonstrated in Wells submissions and as underscored by the fact that the SEC itself had already filed fraud charges in federal court alleging that Gemstar management had lied to the auditors) KPMG negotiated a settlement with the SEC.

The SEC settlement was negotiated in part by senior management of KPMG directly with the Director of Enforcement, Stephen M. Cutler, and it has components designed to improve audit quality. In the settlement, KPMG has undertaken to provide training to its auditors on materiality and multi-element transactions, and has adopted a policy requiring additional consultation with the Firm's national office, the Department of Professional Practice, in potential restatement situations. The SEC Settlement also includes an undertaking pursuant to which the Firm has already deposited $10 million into court for distribution to Gemstar shareholders.

All of these actions, taken as whole, clearly reflect that KPMG is today a Firm that is attempting to work with its regulators to improve audit quality and to work constructively with them to resolve issues in a far less contentious atmosphere than may have existed in the past.

In reaching its settlement with the SEC, KPMG provided information to the Staff of the Enforcement Division of various changes and improvements to KPMG's audit practice in the period of time subsequent to the issuance of the various audit reports on Gemstar's financial statements. Many of those enhanced policies and practices, adopted prior to the SEC settlement, served as the basis for the undertakings agreed to by KPMG in the SEC settlement. In addition to those improvements, which clearly go beyond what is required by generally accepted auditing standards, KPMG has made numerous other structural reforms since 2002. These reforms, implemented under a new management of the Firm, emphasize KPMG's commitment to improving the quality of service it provides to its clients and the users of its clients' financial statements.

In the Spring of 2002, KPMG elected new leadership, which immediately set a goal of improving professional practice and making quality its highest priority. Under the new leadership, KPMG made changes to its structure, its policies and its people.

First, KPMG made some basic, but fundamentally critical, changes to its risk management structure. Previously, the role of Vice Chair of Audit, who was the chief executive of the audit practice and responsible as such for the profits and loss of the audit practice, was also the risk management partner for the audit practice. The Vice Chair of Audit reported directly to the Firm's Deputy Chairman, who was the Chief Operating Officer of the Firm. Additionally, the Firm's National Office, known as the Department of Professional Practice, also reported to the Vice Chair of Audit. New management believed that risk management and professional practice, because of their fundamental importance to the integrity of the audit process, should not be under the supervision of management who also was responsible for running an audit practice in a profitable manner. While recognizing that acting in an ethical and professional manner was in no way inconsistent with running a profitable audit practice, new management believed that separating the management of those two branches of the practice would be a "best practice." Accordingly, a new position was created – Vice Chair of Risk and Regulatory. This office was given a sweeping mandate: the new Vice Chair would sit on the Firm's Management Committee and would have responsibility for a variety of professional, ethical, risk management and regulatory functions, including responsibility for the Department of Professional Practice. Most importantly, the Vice Chair would report directly to the Chairman of the Firm and would have no profit and loss responsibility. Since that fundamental change, the Firm has developed additional enhancements to its practices and procedures.

The Firm's procedures with respect to planning its audits have been revised to be more sensitive to the potential for fraud. For example, the Firm has expanded the use of KPMG's forensic professionals in providing audit assistance. Similarly, analytical techniques developed by and used by merger and acquisition professionals, were migrated to the audit practice. The use of forensic insights and new analytical methodologies to supplement traditional audit procedures is believed to result in more effective auditing.

The Firm developed a system for monitoring restatements, so that lessons could be learned and shared with the Firm's auditing professionals. In this regard, the Firm has also increased its emphasis on technical training and has enlisted the Department of Professional Practice to play a role in bringing more rigor and national consistency to the Firm's training efforts.

The Firm also revised its goal setting and compensation system to emphasize the need to continuously focus on quality. Metrics for evaluating partners have been revised with this in mind. Also, as a result of tracking restatements, the Firm was in a position to consider restatements by clients in connection with partner compensation decisions. As a result of that process partners had their compensation adversely impacted as a result of restatements.

Additionally, recognizing the benefits created by an effective ethics and compliance function, a new position of Ethics and Compliance, reporting to the Vice Chair of Risk and Regulatory, also was created. This lead to the creation of a Firm-wide Code of Conduct backed up by appropriate training for all Firm personnel. The Firm also expanded its internal lines of communication to ensure that anyone in the Firm who had issues and concerns that they believed were not being adequately addressed would have a source through which to voice those concerns. To accomplish this the Firm established an Ethics "Hotline." Firm personnel may raise any issue or concern, anonymously if they wish through the hot-line, which is operated by an outside organization and which is in operation 24/7. KPMG has created an Ethics Committee of its Board of Directors, to establish and ensure an appropriate "tone at the top." The first chairperson of that committee is Teresa Iannaconi, a widely respected partner and former senior official with the Securities and Exchange Commission. All of these programs and structural changes are designed to promote a Firm culture dedicated to ethical and professional excellence.

These are just a few of the many enhancements that have been adopted by the Firm under new management. Other programs and enhancements are in development or in operation as pilot programs. We have shared with the Staff of the Board the details of some of these programs. The goal of all these enhancements is to improve audit quality and to provide the best professional and ethical services possible.

Finally, we wish to bring to the Board's attention, as we did to the attention of the Staff, that KPMG has resolved the claims of Gemstar's investors. As of the date of this letter that settlement has not yet been filed with the Court, but we expect that it will have been filed by the date of the Board's March 18, 2005 meeting.

We respectfully request that this matters be taken into consideration in reviewing the proposed settlement and stand ready to provide additional information should the Board so desire.

Very truly yours,

Joseph P. Loon

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(Enclosures)